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**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE**

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RH06092874 September 22, 2006

INITIAL STATEMENT OF REASONS

California Insurance Commissioner John Garamendi will consider adoption of Section 2653.6 and amendment of Sections 2651.1, 2661.1, 2661.3, 2662.1, 2662.3, and 2662.5 of Subchapter 4.9, Title 10, of the California Code of Regulations.

SPECIFIC PURPOSE OF THE REGULATION

Proposition 103, approved by California voters in 1988, established the requirement that all property-casualty insurers obtain the prior approval of the Insurance Commissioner for proposed rate changes. (Insurance Code §1861.05). Proposition 103 permits consumer participation in the approval process. (Insurance Code §1861.10(a)). It further requires the Commissioner to award reasonable advocacy and witness fees to a consumer when the consumer makes a "substantial contribution" to the adoption of any order, regulation, or decision by the Commissioner or a court. (Insurance Code §1861.10(b)).

As required by Insurance Code §1861.055, the Department has promulgated regulations under Title 10, Chapter 5 of the Code of Regulations (CCR) governing the prior approval process, including regulations governing consumer participation. The Department wishes to amend Subchapter 4.9 (Rules of Practice and Procedure for Rate Proceedings) to clarify that consumers, who participate in the approval process after having filed a petition for a hearing, may seek an award of reasonable advocacy fees.

NECESSITY

The Commissioner has determined that amendment of certain regulations in Subchapter 4.9 is necessary in order to properly implement the requirements, purposes and intent of the statutes. Specifically, the regulations must be amended to make clear that advocacy performed by a consumer representative (whether a "petitioner," "intervenor," or "participant") prior to a decision by the Commissioner to grant or deny a petition for hearing pursuant to Section 1861.05(c) is to be compensated so long as a consumer has made a "substantial contribution" to a decision or order ending the proceeding.

As noted above, section 1861.05(a) authorizes consumers and their representatives to request a hearing to, among other things, review applications for rate changes, or to review a rate presently in effect.

Subdivision 1861.05(c) specifies that upon a timely request, a hearing must be granted when the challenged rate application seeks an adjustment in rates for personal lines (for example, private passenger automobile and homeowners multi-peril insurance) that exceeds 7%, and for an adjustment that exceeds 15% for commercial lines. It is within the Commissioner's discretion whether to grant requests for hearings on applications for changes of less than 7% and 15% respectively.

It has been the Department's practice to encourage consumer representatives and applicants to resolve rate challenges informally so as to avoid engaging in lengthy formal hearings that benefit no one. Often during negotiations, insurers seek to withdraw their rate applications. In some instances, applicants have withdrawn their applications after a petition for a hearing has been filed and after the petitioner has expended substantial time and effort advocating its position through its advocates and experts. In these instances, the result of the informal process has been either no rate change, or a substantial alteration in the rate ultimately approved by the Commissioner. Such results benefit the public without the necessity of conducting a formal hearing.

In several of these instances, either the challenge was settled by the parties or the case was dismissed as moot when the applicant chose to withdraw rather than proceed with its application and potentially be subject to a hearing. After extensive and careful consideration, the Commissioner determined that the

petitioner made a "substantial contribution" to his decision concerning the rate applications even though no hearing was held. Recently, several insurers have objected to the Commissioner's authority to award compensation to petitioners who make a substantial contribution in these circumstances. Responding to certain insurer's arguments, the Commissioner found and determined in awarding fees that

"With respect to the construction of CIC 1861.10, the Commissioner has determined that in fairness to consumers who desire to participate in the public ratemaking process as provided for by Proposition 103, and in furtherance of the purposes of Proposition 103, that a "proceeding" has been "initiated," within the meaning of CIC 1861.10(a) once a Petition for Hearing has been filed pursuant to CCR section 2661.2 and 2661.3(a)."

Despite the statutory requirement of Proposition 103 that the Commissioner *shall* award compensation to any person representing the interests of consumers who make a substantial contribution to his orders of decision, a Superior Court recently ruled that the Commissioner was not authorized to award a petitioner a fee award. Without agreeing with the reasoning and analysis of the Superior Court in that instance, the Commissioner believes that the intervenor regulations should be amended to reflect the fact that once a petition for hearing has been filed, a proceeding has been established and that an insurer may not thereafter withdraw its rate application without approval of the Commissioner. Consumer representatives who make a substantial contribution to the outcome of that proceeding are entitled to compensation for their work, even if the proceeding concludes without a hearing.

The Commissioner believes that the proposed adoption and amendments are not only authorized by, but also necessitated by Proposition 103. Section 1861.10(b) contains only two prerequisites: (1) that the person seeking advocacy and witness fees "represents the interests of consumers"; and (2) that the person has "made a substantial contribution to the adoption of any order, regulation, or decision by the commissioner or a court." (Insurance Code §1861.10(b).) Subsection (b) further provides that "where advocacy occurs in response to a rate application, the award shall be paid by the applicant." (*Ibid.*) When these two statutory conditions are met, the Commissioner "shall award reasonable advocacy and witness fees and expenses." (*Ibid.*)

The Commissioner's view is that the statute plainly mandates that "any person" who "represents the interests of consumers" and who "made a substantial contribution to the adoption of any order, regulation, or decision by the commissioner" is entitled to an award of compensation for reasonable advocacy fees and expenses. An insurer's attempt to withdraw its application in order to avoid paying compensation defeats the purpose of the statutes. Therefore, the Commissioner proposes to adopt a regulation, allowing insurers, in some circumstances, to withdraw rate applications following the filing of a petition by a consumer. The Commissioner's order allowing an insurer to withdraw its application clearly constitutes an "order" or "decision" within the meaning of Section 1861.10(b).

Denying compensation for advocacy performed by a petitioner prior to an insurer's withdrawal of its application would thwart the statute's plain language and its underlying purpose of encouraging consumers to enforce Proposition 103, and disrupt the framework of public participation established by the Department through its regulations, in the following ways:

- It would discourage consumer representatives from challenging rate applications if the consumer representatives faced the risk that its substantial investigation and participation in the informal review process might result in no compensation, even if the outcome was the very outcome sought by the consumer representative. Without the potential for an award of compensation, few if any consumer representatives would be able to afford the resource expenditures needed to participate in a professional manner in the review of such applications.

· Conversely, if the only way to obtain compensation would be to insist upon a hearing - where a hearing is mandatory - consumer representatives will eschew the informal process. This would discourage efficient resolution of challenges.

· It could effectively place the determination of whether intervenors are compensated within the sole control of an insurer, who may unilaterally withdraw, rather than with the Commissioner.

In summary, the Commissioner believes that, as the voters intended, the scrutiny of consumer representatives is an important tool to ensure that applicants comply with the statutory and regulatory prohibition on "excessive, inadequate, and unfairly discriminatory" rates, or rates that otherwise violate the law, and that if consumer representatives are denied the ability to seek compensation when they make a substantial contribution in pre-hearing proceedings, such scrutiny would be discouraged and curtailed.

Such a result contravenes the public policy underlying section 1861.10 and analogous intervenor compensation statutes of encouraging consumer participation in administrative and court proceedings, and thereby aiding regulators and courts in their decisions. (See *Calfarm Ins. Co. v. Deukmaejian* (1989) 48 Cal.3d 805, 836 [voters for Prop. 103 "favored a measure that provides for public regulatory hearings with consumer participation"]; *Economic Empowerment Foundation v. Quackenbush* (1997) 57 Cal.App.4th 677, 686 [courts "should seek an interpretation of the statute which best facilitates compensation"]; *State Farm Mut. Auto. Ins. Co. v. Garamendi* (2004) 32 Cal.4th 1029, 1045 [interpreting section 1861.07 in a manner consistent with Proposition 103's goal of fostering consumer participation in the rate-setting process].)

The Commissioner therefore proposes to adopt and amend regulations to change the definitions related to "proceedings" and to establish an application withdrawal procedure following the filing of a petition for a hearing, so as to ensure that consumer representatives are eligible to seek compensation when they make a substantial contribution to any "order, regulation, or decision by the commissioner" prior to a formal hearing being granted or denied. The balance of the proposed amendments conform various provisions of existing regulations regarding compensation to intervenors in such proceedings to those changes.

Because the amendments do not alter the requirement that the Commissioner determine that a petitioner or intervenor made a "substantial contribution," the Commissioner is confident that the amendments will not infringe upon the Department's ability to police the integrity of the intervenor process.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS

The Commissioner did not rely upon any technical, theoretical, or empirical studies, reports or documents in proposing the adoption and amendment of these regulations.

REASONABLE ALTERNATIVES TO THE REGULATION AND THE AGENCY'S REASONS FOR REJECTING THOSE ALTERNATIVES

No other alternatives to the regulation (including alternatives to lessen any adverse impact on small business) were presented to or considered by the Commissioner. The Commissioner has determined that the proposed amendment will only affect insurance companies and will therefore not affect or impact small business. Pursuant to Government Code section 11342.610(b)(2), insurers are not small businesses.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON ANY BUSINESS

The Commissioner has made an initial determination that adoption of the proposed amendment will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

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Last Revised - September 18, 2006
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